

Message Text

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ACTION EUR-12

INFO OCT-01 EA-10 IO-13 ISO-00 AID-05 CIAE-00 EB-08
FRB-03 INR-10 NSAE-00 ICA-11 XMB-02 OPIC-03 SP-02
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TO SECSTATE WASHDC PRIORITY 5003
TREASURY DEPT WASHDC PRIORITY
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY DUBLIN
AMEMBASSY PARIS
AMEMBASSY ROME
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AMCONSUL BELFAST
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USEEC ALSO FOR EMBASSY
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DEPARTMENT PASS FEDERAL RESERVE BOARD; TREASURY FOR
DONALD E. SYVRUD, OASIA

/

E.O. 11652: N/A
TAGS: ECON, EFIN, UK
SUBJECT: THE BUDGET -- TAX AND EXPENDITURE CHANGES.

SUMMARY: THE CHANCELLOR ANNOUNCED INCOME TAX CUTS OF 2.
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BILLION POUNDS, NO OFFSETTING INCREASES IN INDIRECT TAXE
INCREASED TRANSFER PAYMENTS AND MARGINAL RISES IN PUBLIC
EXPENDITURE TOTALLING 0.55 BILLION POUNDS FINANCED FROM
THE CONTINGENCY RESERVES. THE PACKAGE WENT FURTHEST TO-
WARD MEETING THE GOALS OF THE TUC WHICH HAD PUSHED HARD
FOR A REDUCED RATE TAX BAND. THE LIBERALS GOT NO REDUC-
TION IN THE 34 PERCENT BASIC RATE OF INCOME TAX, THOUGH

A PROFIT-SHARING PROPOSAL, AID TO SMALL BUSINESS, AND LIBERALIZATION OF THE INVESTMENT INCOME SUR-TAX DID GO SOME DISTANCE TOWARD MEETING THEIR PROPOSALS. END SUMMARY.

BEGIN UNCLASSIFIED

1. INCOME TAX CUTS.

A. THE CHANCELLOR ANNOUNCED INCOME TAX CUTS TOTAL- LING 2.4 BILLION POUNDS OVER A FULL YEAR (2.0 BILLION IN FY 78/79). THESE WERE MADE UP OF:

- THE INTRODUCTION OF A REDUCED RATE BAND (25 PERCENT) ON THE FIRST 750 POUNDS OF TAXABLE IN- COME -- COST 1.6 BILLION POUNDS;
- INCREASED PERSONAL EXEMPTIONS OF 40 POUNDS (TO 985 POUNDS) FOR SINGLE TAXPAYERS AND 80 POUNDS (TO 1535 POUNDS) FOR MARRIED TAXPAYERS -- COST 0.55 BILLION POUNDS;
- INCREASED TAX THRESHOLDS OF 1,000 POUNDS ON THE FIRST HIGHER RATE (40 PERCENT) BAND FROM 6,000 TO 7,000 POUNDS WITH CORRESPONDING INCREASES IN SUCCESSIVE BANDS;
- LIBERALIZATION OF INVESTMENT INCOME SURTAXES.

B. THESE MEASURES CONCENTRATE BENEFITS ON INCOMES AT OR BELOW THE NATIONAL AVERAGE OF ABOUT 75 POUNDS PER WEEK. THEY HAVE THE EFFECT OF REMOVING 360,000 PEOPLE FROM THE TAX ROLLS AND A FURTHER 450,000 FROM PAYING TAX LIMITED OFFICIAL USE

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THE BASIC 34PERCENT. THE INVESTMENT IN- COME SURTAX IS LIBERALIZED TO PROVIDE RELIEF FOR THE EL- DERLY.

2. TAXATION OF SMALL BUSINESSES.

A. THE CHANCELLOR, RESPONDING TO PROPOSALS PUT FOR- WARD BY THE LIBERALS, ANNOUNCED A SERIES OF MEASURES OF ASSISTANCE TO SMALL BUSINESS. THESE INCLUDE:

- INCREASED THRESHOLDS BEFORE PROFITS ARE SUBJEC- TO CORPORATION INCOME TAX AT FULL RATES;
- AN OFFSET PROVISION ALLOWING LOSSES INCURRED IN ESTABLISHING A BUSINESS TO BE SET OFF AGAINST INCOME RECEIVED IN PREVIOUS YEARS;
- CAPITAL GAINS TAX RELIEF;
- INCREASE IN VAT THRESHOLD FROM 7,500 TO 10,000 POUNDS;
- INCOME AVERAGING FOR FARMERS WHEN INCOME VARIES BY 30 PERCENT OVER 2 YEARS;
- TAX RELIEF FOR PARTNERSHIPS RESIDENT IN THE UK BUT WORKING ABROAD.

B. WHILE NO ESTIMATES WERE GIVEN OF THE COSTS OF THESE CHANGES, IN THE AGGREGATE THEY ARE LIKELY TO BE

QUITE SMALL. THE ONLY OTHER TAX ANNOUNCEMENT OF INTEREST TO INDUSTRY WAS IN THE AREA OF TAX DEFERRAL ON INVENTORY PROFITS. THE CHANCELLOR ANNOUNCED AN INDEFINITE EXTENSION OF THE CURRENT SCHEME UNTIL A PERMANENT SOLUTION COULD BE FOUND. HE ANNOUNCED HIS INTENTION TO INTRODUCE LEGISLATION IN FY 79/80 PROVIDING FOR A GRADUAL WRITE-OFF

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OF EXISTING LIABILITIES SHOULD NO SUCH SOLUTION EMERGE.

3. PUBLIC EXPENDITURE.

A. THE 550 MILLION POUND INCREASE IN PUBLIC EXPENDITURE COMES FROM WITHIN THE EXISTING 750 MILLION POUND CONTINGENCY RESERVE. THIS REPRESENTS NO INCREASE ABOVE THE LEVEL ANNOUNCED IN THE JANUARY 1978 PUBLIC EX-

PENDITURE WHITE PAPER (SEE LONDON A-41). THE BREAKDOWN
OF THE MEASURES ANNOUNCED BY THE CHANCELLOR IS AS FOL-
LOWS:

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- NATIONAL HEALTH SERVICE - 50 MILLION POUNDS
- EDUCATION - 40 MILLION POUNDS
- ENVIRONMENTAL SERVICES - 20 MILLION POUNDS
- OTHER PROGRAMS - NOT STATED
- SCHOOL MEALS AND MILK
SUBSIDIES - 68 MILLION POUNDS
- CHILD BENEFITS - 165 MILLION POUNDS

B. THIS LIST DOES NOT TOTAL 550 MILLION POUNDS
BECAUSE THE CHILD BENEFIT INCREASES COME INTO EFFECT IN
NOVEMBER AND THEIR FULL IMPACT WILL NOT BE FELT UNTIL
NEXT YEAR.

BEGIN LIMITED OFFICIAL USE

4. COMMENT.

IN ASSESSING THE TAX AND EXPENDITURE CHANGES,
THREE THINGS STAND OUT. FIRST, THE BULK OF THE TAX CUT
IS CONCENTRATED IN THE NARROW REDUCED RATE BAND, THE
CENTERPIECE OF TUC BUDGET PROPOSALS. THE INCIDENCE OF
THIS MEASURE IS SUCH THAT TAXPAYERS EARNING INCOMES AT O
BELOW THE NATIONAL AVERAGE BENEFIT MOST. THIS PROFILE I
CLOSE TO THAT OF THE AVERAGE TRADE UNION MEMBER.

SECOND, THE CHANCELLOR, WITH THE EXCEPTION OF A
NEGLECTIBLE RISE IN THE TAXES ON CIGARETTES, MADE NO IN-
CREASE IN INDIRECT TAXATION. THIS WAS A CLEAR EXPRES-
SION OF HIS CONCERN TO AVOID ADDING TO RETAIL PRICE IN-
CREASES IN A PRE-ELECTION PERIOD. IT ALSO DEMONSTRATED
TO THE LIBERALS THAT AFTER SATISFYING THEM ON SMALL BUSI-
NESS TAXATION AND PROFIT-SHARING, HE WAS PREPARED TO
RESIST THEIR PROPOSALS TO FINANCE CUTS IN THE BASIC RATE
OF INCOME TAX BY RAISING INDIRECT TAXATION. IT SHOULD BE
NOTED THAT GIVEN THE DIFFICULT PATH AHEAD TO THE FINANCE
BILL (SEE LONDON 5353), THE CHANCELLOR MIGHT HAVE PUR-

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POSEFULLY STATED A HARDLINE POSITION ON INDIRECT TAXATION
IN THE KNOWLEDGE THAT SOME CONCESSIONS IN THIS AREA MIGHT
BE NECESSARY AT A LATER STAGE.

THIRD, THE INCREASE IN CHILD BENEFITS IS SMALLER
THAN INFLUENTIAL GROUPS SUCH AS THE CHILD POVERTY ACTION
GROUPS HAD ADVOCATED. IT IS THEREFORE LIKELY THAT AT-

TEMPTSWILL BE MADE DURING THE COURSE OF THE FINANCE BILL
TO INCREASE CHILD BENEFITS.

IT IS ALSO INTERESTING TO NOTE THAT NEARLY ALL THE
EXPENDITURE CHANGES AND THE CHILD BENEFIT INCREASES WERE
LEAKED WEEKS IN ADVANCE OF THE CHANCELLOR'S MESSAGE. THE
ONLY REAL SURPRISE WAS THE ABSENCE OF ANY CUT IN THE
BASIC RATE (FROM 34 PERCENT).

BREWSTER

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